



DAVIS BEHAVIORAL HEALTH INC.

**Consolidated Financial Statements and Single Audit Reports
As of and for the years ended June 30, 2005 and 2004**

Together with Independent Auditors' Report



DAVIS BEHAVIORAL HEALTH, INC.
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Davis Behavioral Health, Inc.
Farmington, Utah

We have audited the accompanying consolidated statement of financial position of **Davis Behavioral Health, Inc. and Affiliates** (the Organization) as of June 30, 2005 and 2004 and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Davis North/South Residential, Inc., an affiliated non-profit organization, which statements reflect total assets of \$497,837 and \$514,347 as of December 31, 2005 and 2004 and total revenues of \$134,443 and \$128,510 for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Davis North/South Residential, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **Davis Behavioral Health, Inc. and Affiliates**, as of June 30, 2005 and 2004, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2006 on our consideration of **Davis Behavioral Health, Inc.'s** internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements of **Davis Behavioral Health, Inc. and Affiliates** taken as a whole. The accompanying supplemental schedules on pages 28 and 29 are presented for purposes of additional analysis and are not a required part of the basic financial statements. In addition, the accompanying Schedule of Expenditures of Federal Awards for **Davis Behavioral Health, Inc.** (excluding the Affiliates) for the year ended June 30, 2005 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Tanner LC

January 31, 2006



DAVIS BEHAVIORAL HEALTH, INC.
Consolidated Statement of Financial Position

Years Ended June 30,

	2005	2004
<u>Assets</u>		
Current assets:		
Cash and cash equivalents	\$ 2,826,770	\$ 3,017,144
Certificates of deposit	502,622	-
Receivables, net	2,734,390	1,875,762
Prepaid expenses	203,919	150,150
Total current assets	6,267,701	5,043,056
Restricted cash	81,617	87,306
Investment	75,000	75,000
Land, buildings, and equipment, net	3,992,070	4,689,308
Total assets	\$ 10,416,388	\$ 9,894,670
<u>Liabilities and Net Assets</u>		
Current liabilities:		
Accounts payable	\$ 1,521,292	\$ 932,405
Accrued liabilities	674,746	684,292
Current portion of mortgage payable	6,247	5,711
Deferred revenue	429,875	15,375
Deposits	702,432	978,370
Total current liabilities	3,334,592	2,616,153
Mortgage payable	504,243	510,490
Long-term compensated absences payable	304,188	446,855
Total liabilities	4,143,023	3,573,498
Commitments and contingencies		
Unrestricted net assets:		
Designated	3,500,000	3,500,000
Undesignated	2,773,365	2,821,172
Total net assets	6,273,365	6,321,172
Total liabilities and net assets	\$ 10,416,388	\$ 9,894,670



DAVIS BEHAVIORAL HEALTH, INC.
Consolidated Statement of Activities

Years Ended June 30,

	<u>2005</u>	<u>2004</u>
Unrestricted net assets:		
Support and revenues:		
Government contracts and grants, net of Medicaid match of \$1,672,243 and \$1,675,219, respectively	\$ 11,892,300	\$ 11,836,934
Client fees and insurance	941,770	977,511
Rental revenue	134,443	128,510
Other	1,154,100	231,179
	<hr/>	<hr/>
Total unrestricted support and revenues	14,122,613	13,174,134
	<hr/>	<hr/>
Expenses:		
Program services:		
Mental health intensive	3,078,400	2,963,032
Mental health out-patient	4,904,244	4,245,155
Substance abuse intensive	1,238,673	1,325,301
Substance abuse out-patient	1,548,682	1,620,162
Prevention and education	674,947	659,108
HUD Project	145,141	136,642
Supporting services:		
Management and general	1,641,473	1,638,080
Consortium	938,860	168,640
	<hr/>	<hr/>
Total expenses	14,170,420	12,756,120
	<hr/>	<hr/>
(Decrease) increase in unrestricted net assets	(47,807)	418,014
	<hr/>	<hr/>
Net assets, beginning of year	6,321,172	5,903,158
	<hr/>	<hr/>
Net assets, end of year	\$ 6,273,365	\$ 6,321,172
	<hr/>	<hr/>



	Program Services			
	Mental Health Intensive	Mental Health Out-Patient	Substance Abuse Intensive	Substance Abuse Out-Patient
Salaries and benefits	\$ 1,720,287	\$ 3,575,219	\$ 938,371	\$ 1,260,584
Travel and training	15,789	63,099	11,079	24,974
Office expense	4,545	18,591	5,996	7,315
Supplies and maintenance	61,182	141,092	50,906	38,003
Utilities and telephone	51,612	99,106	30,405	35,933
Inpatient hospital and foster	865,351	32,935	5,918	-
Contractual	40,060	562,383	2,950	15,056
Rent	31,032	20,250	-	-
Medical and testing supplies	1,927	5,610	441	7,940
Therapeutic recreation	13,958	13,123	11,924	5,363
Insurance	36,007	52,477	26,648	24,210
Meals	40,044	3,528	49,730	3,026
Miscellaneous	5,735	11,567	189	2,868
Depreciation	87,092	141,737	61,806	70,789
Advertising	5,717	3,537	-	3
Bad debt expense	108,062	159,990	42,310	52,618
Interest and fiscal charges	-	-	-	-
	\$ 3,078,400	\$ 4,904,244	\$ 1,238,673	\$ 1,548,682

See accompanying notes to consolidated financial statements.

DAVIS BEHAVIORAL HEALTH, INC.
Consolidated Statement of Functional Expenses

Year Ended June 30, 2005

Prevention and Education	HUD Project	Total	Supporting Services		Overall Total
			Management and General	Consortium	
\$ 338,306	\$ 26,425	\$ 7,859,192	\$ 844,213	\$ -	\$ 8,703,405
15,259	1,759	131,959	24,978	-	156,937
6,486	6,727	49,660	74,696	-	124,356
21,142	6,385	318,710	77,894	52,398	449,000
16,804	11,418	245,278	25,475	622	271,375
-	-	904,204	8,164	-	912,368
182,530	-	802,979	385,010	559,106	1,747,095
-	-	51,282	62,720	-	114,002
102	-	16,020	-	-	16,020
25,562	-	59,930	-	-	59,930
12,832	2,910	155,084	28,190	-	183,274
10,755	-	107,028	2,524	-	109,552
601	18,156	39,116	3,305	-	42,421
23,897	25,129	410,390	75,851	326,736	812,977
-	6	9,263	25,844	-	35,107
20,786	-	383,766	-	-	383,766
-	46,226	46,226	2,609	-	48,835
\$ 674,947	\$ 145,141	\$ 11,590,087	\$ 1,641,473	\$ 938,860	\$ 14,170,420



	Program Services			
	Mental Health Intensive	Mental Health Out-Patient	Substance Abuse Intensive	Substance Abuse Out-Patient
Salaries and benefits	\$ 1,780,123	\$ 3,551,532	\$ 976,937	\$ 1,359,765
Travel and training	19,720	60,456	4,271	21,608
Office expense	14,323	22,500	8,548	14,599
Supplies and maintenance	91,261	79,249	41,404	37,099
Utilities and telephone	48,240	65,954	26,739	35,894
Inpatient hospital and foster	615,863	-	68,429	-
Contractual	77,493	123,366	14,598	22,090
Rent	37,395	3,331	239	292
Medical and testing supplies	4,335	2,668	3,595	4,985
Therapeutic recreation	13,858	15,043	11,147	6,757
Insurance	44,770	64,096	20,016	24,462
Meals	19,758	-	41,929	-
Miscellaneous	2,387	4,222	386	2,444
Depreciation	49,207	36,010	41,437	9,210
Advertising	353	6,927	158	528
Bad debt expense	143,794	209,500	65,399	80,345
Interest and fiscal charges	-	-	-	-
Information technology	154	221	69	84
	\$ 2,963,032	\$ 4,245,155	\$ 1,325,301	\$ 1,620,162

See accompanying notes to consolidated financial statements.

DAVIS BEHAVIORAL HEALTH, INC.
Consolidated Statement of Functional Expenses

Year Ended June 30, 2004

Prevention and Education	HUD Project	Total	Supporting Services		Overall Total
			Management and General	Consortium	
\$ 414,886	\$ 26,390	\$ 8,109,633	\$ 1,065,599	\$ -	\$ 9,175,232
38,702	1,683	146,440	60,667	-	207,107
20,314	6,158	86,442	99,064	-	185,506
21,831	4,462	275,306	43,909	-	319,215
19,448	10,822	207,097	40,738	443	248,278
-	-	684,292	-	-	684,292
32,852	-	270,399	122,545	-	392,944
119	-	21,436	47,050	-	88,486
475	-	16,058	-	-	16,058
51,894	-	98,717	1,294	-	100,011
9,958	2,391	165,693	9,031	-	174,724
-	-	61,687	-	-	61,687
6,358	15,088	30,885	23,541	-	54,426
4,106	22,876	162,846	101,216	-	264,062
4,428	56	12,450	20,597	-	33,047
33,703	-	532,741	-	-	532,741
-	46,716	46,716	2,829	-	49,545
34	-	562	-	168,197	168,759
\$ 659,108	\$ 136,642	\$ 10,949,400	\$ 1,638,080	\$ 168,640	\$ 12,756,120



DAVIS BEHAVIORAL HEALTH, INC.
Consolidated Statement of Cash Flows

Years Ended June 30,

	2005	2004
Cash flows from operating activities:		
Cash received from contracts and grants	\$ 11,551,641	\$ 11,727,235
Cash received from patient fees and insurance	892,318	933,071
Cash received from rent	134,443	128,799
Cash received from other revenues and support	806,382	229,631
Cash payments for payroll and benefits	(8,856,376)	(8,956,070)
Cash payments for goods and services	(4,118,161)	(3,327,282)
Net cash provided by operating activities	410,247	735,384
Cash flows from investing activities:		
Purchases of land, buildings, and equipment	(115,739)	(1,038,472)
Deposit into certificate of deposit	(502,622)	-
Receipt of consortium deposits	17,762	659,037
Decrease in restricted cash	5,689	2,759
Net cash used in investing activities	(594,910)	(376,676)
Cash flows from financing activities:		
Mortgage principal payments	(5,711)	(4,997)
(Decrease) increase in cash and cash equivalents	(190,374)	353,711
Cash and cash equivalents at beginning of year	3,017,144	2,663,433
Cash and cash equivalents at end of year	\$ 2,826,770	\$ 3,017,144
Reconciliation of (decrease) increase in net assets to net cash provided by operating activities:		
(Decrease) increase in net assets	(47,807)	418,014
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation	812,977	264,061
Net change in allowance for doubtful accounts	18,421	(47,293)
(Increase) decrease in:		
Receivables	(877,049)	(81,064)
Prepaid expenses	(53,769)	10,236
Increase (decrease) in:		
Accounts payable	588,887	(20,066)
Accrued liabilities	(9,546)	167,963
Deferred revenue	414,500	-
Deposits	(293,700)	-
Long-term compensated absences payable	(142,667)	23,533
Net cash provided by operating activities	\$ 410,247	\$ 735,384



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements

June 30, 2005 and 2004

**1. Organization
and
Summary of
Significant
Accounting
Policies**

Organization

Davis Behavioral Health, Inc., (DBH) (the Organization) is a Utah not-for-profit corporation, which is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Organization is a subsidiary of DBH Holding Corporation. The Organization provides and administers mental health and alcohol and drug prevention and treatment services in Davis County, Utah.

Consolidated Financial Statements

The consolidated financial statements include the accounts of Davis Behavioral Health, Inc. and an affiliated not-for-profit organization which is consolidated with DBH, under the requirements of Statement of Position 94-3, "Reporting of Related Entities by Not-for-Profit Organizations." The consolidated affiliate is Davis North/South Residential, Inc. (the "Affiliate"), an apartment project constructed using financing obtained through the U.S. Department of Housing and Urban Development (HUD). The apartments are used to provide housing for clients of DBH. The accounts of Davis North/South Residential, Inc. included in the consolidated financial statements of DBH are as of and for the years ended December 31, 2004 and 2003. However, the accounts of Davis North/South Residential, Inc. are not materially different from those reported as of June 30, 2005 and 2004 and for the years then ended. Therefore, the effect of using a different reporting period for Davis North/South Residential, Inc. in the consolidated financial statements is not material. On December 7, 2004, the Organization established Hope Apartments, LLC (Hope) with the Organization as the single member. The intent of Hope is to facilitate use of a HUD grant awarded the Organization on July 15, 2004 for \$750,000 to construct an apartment complex for low income individuals who meet the grant criteria. The Organization anticipates an additional investor/member to join Hope in April 2006 to take advantage of low income housing credits available through the project. The first draw of \$145,000 was made on September 23, 2005. The Organization transferred title of land, with a cost basis of \$75,000, to Hope on May 9, 2005. It is estimated that construction of the project will begin in April of 2006 and be completed in September 2006.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**1. Organization
and
Summary of
Significant
Accounting
Policies**
Continued

Financial Statement Presentation

The Organization reports information regarding its financial position and activities according to three classes of net assets, as applicable: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Concentration of Credit Risk

A significant portion of the Organization's revenues and receivables are generated from federal, state and local government entities located primarily in Utah.

The Organization maintains cash in bank deposit accounts, which at times exceed insured limits. The Organization has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents. The Organization had cash and cash equivalents and certificates of deposit in excess of federally insured limits by approximately \$3,150,000 at June 30, 2005.

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, the Organization considers all unrestricted highly liquid investments with an initial maturity of three months or less to be cash equivalents.

Receivables

Receivables are carried at the original billed amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a periodic basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

Restricted Cash

Restricted cash represents cash held for a former employee, in a separate bank account, that is used to pay the insurance premiums of that former employee. In addition, restricted cash includes replacement reserves and residual receipts for Davis North/South Residential, Inc., as required by HUD.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**1. Organization
and
Summary of
Significant
Accounting
Policies**
Continued

Land, Buildings and Equipment

The Organization capitalizes all expenditures for land, buildings and equipment in excess of \$2,000, at cost. The fair value of donated land, buildings and equipment is similarly capitalized. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets or lease terms. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in the Consolidated Statement of Activities for the period. The cost of maintenance and repairs is charged to expense as incurred.

Deposits

The Organization has entered into an agreement with other nonprofit and government entities to develop software for the use of parties to this agreement and not for sale to outside parties. The agreement expires in August 2012, or earlier, provided that the withdrawing entity has given 120 days prior written notice and satisfied all obligations under the agreement. DBH has received cash, and recorded receivables, from the other nonprofit entities, collectively referred to as a "consortium". It is anticipated that all contributing entities will use and benefit from the software. However, legal title to the assets rests with Davis Behavioral Health, Inc. Therefore, the Organization records 100% of the software in "Land, Buildings and Equipment" as purchased, and initially records the cash received and receivable from the other organizations as a liability, under the caption "Deposits", on the Statement of Financial Position.

The deposit liability is relieved, and revenue recognized, over the estimated useful life of the software.

Compensated Absences

Compensated absences represent amounts due to employees of DBH for unused vacation and vested sick leave at June 30, 2005 and 2004. The estimated current portion of compensated absences is included on the Statement of Financial Position under the caption "Accrued Liabilities".



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**1. Organization
and
Summary of
Significant
Accounting
Policies**
Continued

Revenue Recognition and Deferred Revenue

Revenue is recognized when services are performed and collection is reasonably assured. Deferred revenue represents amounts received for services that will be performed in future periods. The Organization recognizes these amounts as contract revenue in the Statement of Activities when the services are performed and no further obligation exists.

Contributions

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. All other donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions.

Donated Property and Equipment

Donations of property and equipment are recorded as support at their estimated fair value at the date of donation. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets must be maintained, the Organization reports expirations of donor restrictions when the donated or acquired assets are placed in service as instructed by the donor. The Organization reclassifies temporarily restricted net assets to unrestricted net assets at that time.

Donated Services

No amounts have been reflected in the consolidated financial statements for donated services. The Organization pays for most services requiring specific expertise. However, many individuals volunteer their time and perform a variety of tasks that assist the Organization with specific programs and assignments.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

1. Organization and Summary of Significant Accounting Policies
Continued

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the Consolidated Statement of Activities and in the Consolidated Statements of Functional Expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Estimates in Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Reclassification

Certain amounts in the 2004 financial statements have been reclassified to conform with the 2005 presentation.

2. Receivables

Receivables consist of the following at June 30:

	<u>2005</u>	<u>2004</u>
Cost reimbursement and fee-for-service contracts with government agencies	\$ 2,423,296	\$ 1,597,414
Receivables from clients and insurance companies	<u>340,950</u>	<u>343,800</u>
	2,764,246	1,941,214
Less allowance for doubtful accounts and insurance denials	<u>(320,841)</u>	<u>(302,420)</u>
	2,443,405	1,638,794
Consortium receivables	193,520	232,078
Other receivables	<u>97,465</u>	<u>4,890</u>
Total receivables, net	<u>\$ 2,734,390</u>	<u>\$ 1,875,762</u>

3. Investment

The Organization owns stock in Mental Health Risk Retention Group with a cost and estimated fair market value of \$75,000. DBH's ownership percentage is less than 20%.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**4. Land,
Buildings,
and
Equipment**

Land, buildings and equipment consist of the following at June 30:

	<u>2005</u>	<u>2004</u>
Land	\$ 484,106	\$ 484,106
Buildings and improvements	3,906,424	3,881,074
Equipment	1,074,938	1,065,567
Vehicles	185,708	185,708
Furniture and fixtures	138,354	135,654
Consortium hardware and software	<u>1,869,914</u>	<u>1,791,595</u>
Total cost	7,659,444	7,543,704
Less accumulated depreciation	<u>(3,667,374)</u>	<u>(2,854,396)</u>
	<u>\$ 3,992,070</u>	<u>\$ 4,689,308</u>

**5. Accrued
Liabilities**

Accrued liabilities consist of the following at June 30:

	<u>2005</u>	<u>2004</u>
Salaries payable	\$ 266,509	\$ 429,487
Payroll taxes and benefits payable	152,036	137,320
Compensated absences-current	249,671	111,713
Other accrued liabilities	<u>6,530</u>	<u>5,772</u>
	<u>\$ 674,746</u>	<u>\$ 684,292</u>

**6. Mortgage
Payable**

The Affiliate has a mortgage payable to HUD. The note is due in equal monthly principal and interest instalments of \$4,328. The mortgage note is collateralized by land and a building. The note bears interest at 9% per annum. The mortgage note is due January 2029.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

6. Mortgage Payable
Continued

Future maturities are as follows:

Year ending June 30:

2006	\$ 6,247
2007	6,833
2008	7,473
2009	8,175
2010	9,780
Thereafter	<u>471,982</u>
	<u>\$ 510,490</u>

7. Designated Net Assets

The Board of Directors had designated \$3,500,000 of the net assets to be set aside for contractual requirements, obligations for accrued leave, and projected needs for facilities and infrastructure.

8. Contracts

DBH has entered into an agreement with Davis County, Utah (the County) to provide substantially all of the mental health services which are required to be provided by the County. In addition, DBH has an agreement to provide substantially all alcohol and drug related services in Davis County. Under the terms of these agreements, DBH provides certain mutually agreed upon mental health and alcohol and drug related services in exchange for fees, which are mutually negotiated annually based on DBH's costs and other revenue sources. The County has also assigned DBH their interest in various mental health and substance abuse contracts with other government agencies. The County includes DBH as a component unit in the Davis County combined financial statements.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

9. Related Party Transactions

The Organization is affiliated with several other entities, which like DBH are also subsidiaries of **DBH Holding Corporation**. DBH Holding Corporation was formed on July 14, 2004. The entities and their functions are as follows: **Daybreak Behavioral Healthcare** (a nonprofit organization) was formed February 5, 2005, to provide mental health and substance abuse services for individuals with a higher acuity who have available means of payment. **Diversified Employment Opportunities, Inc.** (a nonprofit organization) was formed July 29, 2004, to provide training and employment for those individuals with previous employment failures as a bridge to independence. **The Family Behavioral Health Foundation, Inc.** (a nonprofit organization) was formed July 14, 2004 to provide fundraising services in support of mental health and substance abuse services and family well-being. **Davis Employment Services, Inc.** (a nonprofit organization) was formed March 4, 2005, to provide employment services to support the affiliate corporations, excluding Davis Behavioral Health, Inc.

Although affiliated with DBH, none of these entities meets the criterion to consolidate with DBH.

No transactions with these entities occurred during the year ended June 30, 2004. Transactions with these entities for the year ended June 30, 2005 are as follows:

- DBH paid approximately \$41,500 in start-up costs for The Family Behavioral Health Foundation.
- DBH recorded revenue from Daybreak Behavioral Healthcare of approximately \$79,000 for expenses paid by DBH on behalf of Daybreak Behavioral Healthcare, of which \$76,000 is included in receivables as of June 30, 2005.
- DBH paid Diversified Employment Opportunities, Inc. approximately \$21,000 for janitorial services.
- DBH had a receivable of approximately \$17,000 from Diversified Employment Opportunities, Inc. as of June 30, 2005.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

10. Retirement Plans

The Organization makes contributions to a multi-employer defined benefit retirement plan administered by the Utah Retirement System. These contributions are determined in accordance with provisions of the plan. Information as to the Organization's portion of the accumulated plan benefits, plan net assets and unfunded vested benefits is not determinable. In the event of withdrawal from the plan, the Organization may be subject to payment of a withdrawal liability. Management does not intend to take any action which would subject it to such liability. Also, Utah State law allows withdrawals only under certain limited circumstances.

In addition to the above plan, the Organization also has a defined contribution retirement plan covering most employees. The plan is funded by employee contributions and by the Organization at a set percent of the participating employee's compensation.

Contributions to the above described plans were as follows for the years ended June 30:

	<u>2005</u>	<u>2004</u>
Defined benefit plan:		
Employer's contribution	\$ 605,248	\$ 545,251
401 (k) plan:		
Employer contributions	\$ 213,009	\$ 197,089
Employees' contributions	\$ 196,815	\$ 192,754

Salaries subject to retirement plan contributions totalled \$5,457,693 and \$5,667,884 for the years ended June 30, 2005 and 2004, respectively.



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**11. Commitments
and
Contingencies**

Long Term Contracts

Davis Behavioral Health, Inc. is party to numerous contracts with government and private agencies to provide services. Certain contracts may require adjustments to be made to revenues received based on events or, changes in requirements, that are not currently determinable. The amount of these adjustments, if any, is also not currently determinable. However, such adjustments could be material to the consolidated financial statements.

Litigation

The Organization may become or is subject to investigations, claims or lawsuits ensuing out of the normal conduct of its business. The Organization is currently not aware of any such items that it believes could have a material affect on its financial position.

Service Contract

The Organization has entered into a contract for services related to the consortium software. Under the contract, the Organization is obligated to pay \$350,000 a year through August 2008. The contract may be extended by either party for two additional three-year terms.

Loan Guarantee for Related Parties

As of December 31, 2005, the Organization has pledged certificates of deposit in the amount of \$502,622 (including accrued interest) to secure lines of credit of affiliated organizations.

**12. Significant
Sources of
Support**

A small number of funding sources represent a significant portion of the Organization's total support and revenues during the years ended June 30, 2005 and 2004. The breakdown is approximately as follows:

	<u>2005</u>	<u>2004</u>
Funding Source A	\$ 4,988,000	\$ 5,090,000
Funding Source B	2,506,000	2,419,000
Funding Source C	2,393,000	2,315,000
	<u>\$ 9,887,000</u>	<u>\$ 9,824,000</u>



DAVIS BEHAVIORAL HEALTH, INC.
Notes to Consolidated Financial Statements
Continued

**13. Subsequent
Events**

On January 3, 2006, the Organization purchased an office building and adjacent vacant lot in Layton, Utah for \$5,495,000. As part of the purchase, the Organization exchanged two properties (an office building in Clearfield, Utah and one in Farmington, Utah), took out a loan of \$3,825,000, and received a charitable gift of \$790,000 towards the purchase price.

DBH Properties, (a single member LLC, with the Organization as the single member) was formed in November 2005 to manage the rental operations of the new property referred to above. The Organization will occupy part of the building and lease out the remainder of the space to the current leaseholders.



DAVIS BEHAVIORAL HEALTH, INC.
Schedule of Expenditures of Federal Awards

Year Ended June 30, 2005

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number	Pass- Through Grantors' Numbers	Federal Expenditures
U.S. Department of Health and Human Services:			
Block Grant for Prevention and Treatment of Substance Abuse passed through Davis County	93.959	20294	\$ 1,614,835
Block Grant for Community Mental Health Services passed through Davis County	*93.958	20262	272,154
Consolidated Knowledge Development and Application (KD&A) Program passed through Davis County	*93.230	21366	316,039
Social Services Block Grant passed through Utah State Department of Human Services	93.667		<u>49,921</u>
Total U.S. Department of Health and Human Services			<u>2,252,949</u>
U.S. Department of Education:			
Safe and Drug Free Schools and Communities passed through Davis County School District	*84.184A		97,618
Drug Free Schools passed through Davis County	84.186B	20294	<u>56,606</u>
Total U.S. Department of Education			<u>154,224</u>



DAVIS BEHAVIORAL HEALTH, INC.
Schedule of Expenditures of Federal Awards
Continued

Federal Grantor/ Pass Through Grantor/ Program Title	Federal CFDA Number	Pass- Through Grantors' Numbers	Federal Expenditures
U.S. Department of Justice:			
Byrne Formula Grant passed through Davis County	16.579	4D75	10,919
Residential Substance Abuse Treatment for State Prisoners passed through Davis County	16.593	3R03	28,257
Drug Courts Discretionary Grant Program	16.585		<u>57,236</u>
Total U.S. Department of Justice			<u>96,412</u>
Total federal expenditures			<u>\$ 2,503,585</u>

Note 1 – Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Davis Behavioral Health, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

* Denotes a major program



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REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

**To the Board of Directors of
Davis Behavioral Health, Inc.**

We have audited the consolidated financial statements of Davis Behavioral Health, Inc. and Affiliate as of and for the year ended June 30, 2005, and have issued our report thereon dated January 31, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Davis Behavioral Health, Inc.'s consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Davis Behavioral Health, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Davis Behavioral Health, Inc.'s ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 05-1, and 05-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe reportable condition 05-1, included in the Schedule of Findings and Questioned Costs, is a material weakness. In addition, we noted certain other comments which are communicated to the management of Davis Behavioral Health, Inc. in a separate letter dated January 31, 2006.

This report is intended solely for the information of the Board of Directors, management and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by any one other than these specified parties.

Tanner LC

January 31, 2006



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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors of
Davis Behavioral Health, Inc.

Compliance

We have audited the compliance of Davis Behavioral Health, Inc. with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2005. Davis Behavioral Health, Inc.'s major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of Davis Behavioral Health, Inc.'s management. Our responsibility is to express an opinion on Davis Behavioral Health, Inc.'s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Davis Behavioral Health, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Davis Behavioral Health, Inc.'s compliance with those requirements.

In our opinion, Davis Behavioral Health, Inc. complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005.

Internal Control Over Compliance

The management of Davis Behavioral Health, Inc. is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Davis Behavioral Health, Inc.'s internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the Board of Directors, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by any one other than these specified parties.

Tanner LC

January 31, 2006



DAVIS BEHAVIORAL HEALTH, INC.
Schedule of Findings and Questioned Costs

Year Ended June 30, 2005

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified.

Internal control over financial reporting:

- Material weakness(es) identified? X yes no
- Reportable condition(s) identified that are not considered to be material weaknesses? X yes no

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? yes X no
- Reportable condition(s) identified that are not considered to be material weaknesses? yes X no

Type of auditor's report issued on compliance for major programs: Unqualified.

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? yes X no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
93.958	Block Grant for Community Mental Health Services
93.230	Consolidated Knowledge Development and Application Program
84.184A	Safe and Drug Free Schools and Communities

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? X yes no



DAVIS BEHAVIORAL HEALTH, INC.
Schedule of Findings and Questioned Costs
Continued

Section II – Financial Statement Findings

05-1 – Patient and Insurance Accounts Receivable Reports

Criteria:

Detailed accounts receivable reports should be available to support accounts receivable balances reported on the general ledger.

Condition:

The Organization's new patient and insurance billing software was unable to produce accounts receivable reports as of June 30, 2005, to support accounts receivable reported on the general ledger.

Effect:

Organization personnel were unable to reconcile patient and insurance accounts receivable balances as of June 30, 2005, which resulted in a material audit adjustment.

Cause:

The Organization is in the process of developing a new patient and insurance software system, and at the current time, the system is unable to produce all of the reports customarily used for accounting purposes.

Recommendation:

We recommend that management continue consulting with the software developers to ensure that the necessary accounts receivable reports are made available as soon as possible.

Davis Behavioral Health, Inc.'s Response:

Management is working with the software vendor to correct the problem and anticipate a correction with the next update.

05-2 – Employee Expense Reimbursements

Criteria:

Controls over employee expense reimbursements have as a primary purpose the proper payment and recording of all expense reimbursements.



DAVIS BEHAVIORAL HEALTH, INC.
Schedule of Findings and Questioned Costs
Continued

Condition:

During the audit we became aware of certain immaterial instance in which an Officer of the Organization was overpaid on expense reimbursements in a prior fiscal year. These amounts were included in accounts receivable on the general ledger. The total of the overpayments was \$1,196. The organization has been repaid the full amount. Upon their identification of this situation, the Organization's Board of Directors engaged independent accountants to perform additional procedures pertaining to employee expense reimbursements, and made an assignment change within organizational responsibilities.

Effect:

As noted above, the Organization overpaid certain expense reimbursements to this individual totaling \$1,196.

Cause:

A likely cause was lack of sufficient training or oversight of the personnel processing expense reimbursement requests.

Recommendation:

We recommend that management carefully and periodically review the Organization's employee expense reimbursement policies and procedures, and also provide periodic training to all individuals assigned responsibilities in this area.

Davis Behavioral Health, Inc.'s Response:

The Organization has implemented changes to its internal control procedures relating to employee reimbursements to reduce the possibility of duplicate payments for the same travel dates. The Organization will also prepare policy and procedures relating to any employee receivables that will specify the manner and time frame for disclosure and repayment.

Section III – Federal Award Findings and Questioned Costs

No findings noted



DAVIS BEHAVIORAL HEALTH, INC.
Summary Schedule of Prior Audit Findings

Year Ended June 30, 2005

No findings were noted for the year ended June 30, 2004.



DAVIS BEHAVIORAL HEALTH, INC.
Supplemental Statement of Financial Position
with Details of Consolidation

June 30, 2005

	Davis Behavioral Health, Inc. (excluding consortium project)	Consortium Project	Davis North/South Residential, Inc.	Elimin- ations	Consoli- dated
<u>Assets</u>					
Current assets:					
Cash and cash equivalents	\$ 1,443,375	\$ 1,378,946	\$ 4,449	\$ -	\$ 2,826,770
Certificates of deposit	502,622	0	-	-	502,622
Receivables, net	4,134,725	193,520	106	(1,593,961)	2,734,390
Prepaid expenses	162,515	40,694	710	-	203,919
Total current assets	6,243,237	1,613,160	5,265	(1,593,961)	6,267,701
Restricted cash	25,754	-	55,863	-	81,617
Investment	75,000	-	-	-	75,000
Land, buildings, and equipment, net	2,852,929	702,432	436,709	-	3,992,070
Total assets	\$ 9,196,920	\$ 2,315,592	\$ 497,837	\$ (1,593,961)	\$ 10,416,388
<u>Liabilities and Net Assets (Deficit)</u>					
Current liabilities:					
Accounts payable	\$ 1,500,808	\$ 1,613,160	\$ 1,285	\$ (1,593,961)	\$ 1,521,292
Accrued liabilities	668,216	-	6,530	-	674,746
Current portion of mortgage payable	-	-	6,247	-	6,247
Deferred revenue	429,875	-	-	-	429,875
Deposits	-	702,432	-	-	702,432
Total current liabilities	2,598,899	2,315,592	14,062	(1,593,961)	3,334,592
Mortgage payable	-	-	504,243	-	504,243
Long-term compensated absences payable	304,188	-	-	-	304,188
Total liabilities	2,903,087	2,315,592	518,305	(1,593,961)	4,143,023
Commitments and contingencies					
Unrestricted net assets (deficit)	6,293,833	-	(20,468)	-	6,273,365
Total liabilities and net assets	\$ 9,196,920	\$ 2,315,592	\$ 497,837	\$ (1,593,961)	\$ 10,416,388



DAVIS BEHAVIORAL HEALTH, INC.
Supplemental Statement of Activities
with Details of Consolidation

Year Ended June 30, 2005

	Davis Behavioral Health, Inc. (excluding consortium project)	Consortium Project	Davis North/South Residential, Inc.	Elimin- ations	Consoli- dated
Unrestricted net assets:					
Support and revenues:					
Government contracts and grants, net of medicaid match of \$1,672,243	\$ 11,892,300	\$ -	\$ -	\$ -	\$ 11,892,300
Client fees and insurance	941,770	-	-	-	941,770
Rental revenue	-	-	134,443	-	134,443
Other	215,240	938,860	-	-	1,154,100
Total unrestricted support and revenues	13,049,310	938,860	134,443	-	14,122,613
Expenses:					
Program services:					
Mental health intensive	3,078,400	-	-	-	3,078,400
Mental health out-patient	4,904,244	-	-	-	4,904,244
Substance abuse intensive	1,238,673	-	-	-	1,238,673
Substance abuse out-patient	1,548,682	-	-	-	1,548,682
Prevention and education	674,947	-	-	-	674,947
HUD Project	-	-	145,141	-	145,141
Supporting services:					
Management and general	1,641,473	-	-	-	1,641,473
Consortium	-	938,860	-	-	938,860
Total expenses	13,086,419	938,860	145,141	-	14,170,420
Increase (decrease) in unrestricted net assets	(37,109)	-	(10,698)	-	(47,807)
Net assets (deficit), beginning of year	6,330,942	-	(9,770)	-	6,321,172
Net assets (deficit), end of year	\$ 6,293,833	\$ -	\$ (20,468)	\$ -	\$ 6,273,365

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January 31, 2006

**To the Board of Directors of
Davis Behavioral Health, Inc.**

Dear Members:

We have audited the consolidated financial statements of **Davis Behavioral Health, Inc. and Affiliate**, (the Organization) as of and for the year ended June 30, 2005, and have issued our report thereon dated January 31, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards And OMB Circular A-133

Our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the Organization's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the Organization's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Davis Behavioral Health, Inc.'s compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement applicable to its major federal program for the purpose of expressing an opinion on Davis Behavioral Health, Inc.'s compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide legal determination on Davis Behavioral Health, Inc.'s compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Organization are described in Note 1 to the consolidated financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2005.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the consolidated financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements are the allocation percentages for certain expenses among program and supporting services, the percentage of compensated absences classified as current, the amount of receivables considered collectible, and the lives assigned to depreciable assets.

Management's estimate related to the allocation of certain expenses among program and supporting services is primarily based upon the time spent by employees working on the various programs or performing supporting services. The percentage of compensated absences classified as a current liability and the lives assigned to depreciable assets are based upon prior experience, and in the case of depreciable lives, consideration is given to common industry practice. The amount of receivables considered collectible is determined by considering the age of the receivables and prior experience. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the consolidated financial statements taken as a whole.

Significant Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Organization's financial reporting process (that is, cause future financial statements to be materially misstated). Significant audit adjustments were recorded for accounts receivable and certain accrued liabilities.

Uncorrected Misstatements

We also accumulated one uncorrected misstatement, which was discussed with management and was determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole. Therefore, the adjustment to correct this misstatement was not made to the financial statements. This uncorrected misstatement is summarized in the accompanying schedule.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the consolidated financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Organization's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Independence

There are no relationships between Tanner LC and its related individuals or entities and the Organization and its related individuals or entities that in our professional judgment may reasonably be thought to impair our independence.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Organization's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered some difficulty in performing the audit due to the lack of reports pertaining to patient and insurance accounts receivable, and due to the fact that certain general ledger accounts were unable to be fully reconciled by the start of audit fieldwork.

This information is intended solely for the use of the Board of Directors and management, and should not be used for any other purpose. If you have questions concerning the above items, we will be happy to discuss them with you.

Sincerely,

Tanner LC

Uncorrected Misstatement

Account	Description	Debit	Credit
Proposed JE # 1			
To accrue FICA and insurance payable at year end			
50400	Benefits general	38,529.00	
50401	FICA expense	19,754.00	
30200	FICA payable		19,754.00
30800	PEHP payable		38,529.00
Total		58,283.00	58,283.00

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January 31, 2006

**To the Board of Directors of
Davis Behavioral Health, Inc.**

In planning and performing our audit of the consolidated financial statements of Davis Behavioral Health, Inc. and Affiliate (the Organization) for the year ended June 30, 2005, we considered the Organization's internal control to determine our auditing procedures for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurance on internal control.

However, during our audit we became aware of the following matters that represent opportunities for strengthening internal control and/or operating efficiency. The memorandum that accompanies this letter summarizes our comment and suggestion regarding these matters. This letter does not affect our report dated January 31, 2006, on the consolidated financial statements of Davis Behavioral Health, Inc. and Affiliate.

We will review the status of these comments during our next audit engagement. We have already discussed these comments with Organization personnel, and we will be pleased to discuss them in further detail at your convenience.

Sincerely,

Tanner LC

Fee-for-Service Billings

Observation

The Organization deployed a new patient and insurance information system during the year to track services provided, billings, and collections. Due to issues pertaining to the submission of information from this system to government agencies, some Medicare and Medicaid billings have initially been rejected, resulting in a sizable increase in receivables from these government programs. Although management is confident that all amounts due from Medicaid and Medicare for fee-for-service billings will ultimately be collected, the delay has had a negative effect on the Organization's cash flow.

Recommendation

We recommend that management continue in the effort to resubmit the necessary billing information to Medicaid and Medicare, and continue to investigate the cause of the billing rejections so that the issues will be eliminated for future billings to these agencies.

Davis Behavioral Health, Inc.'s Response

Management has worked with the software vendor and all corrections have been made. All billings have been re-submitted to Medicare and Medicaid.

Timely Reconciliation of Certain General Ledger Accounts

Observation

There were certain general ledger accounts that had not been fully reconciled at the time we began our audit for the year ended June 30, 2005. A factor contributing to this occurrence appears to be the need to prepare simultaneously for a Medicaid cost report audit.

Recommendation

We recommend that management consider the level of staffing in the accounting department to ensure that sufficient resources are available to complete the critical task of reconciling general ledger accounts in a timely manner, even when other factors add to the workload.

Davis Behavioral Health, Inc.'s Response

The accounting department did experience the loss of one accountant prior to the audit. The open position has been filled. Management will also schedule audits for the coming year to allow time for completion of reconciliation.



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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH UTAH STATE REQUIREMENTS

**To the Board of Directors of
Davis Behavioral Health, Inc.**

We have audited the consolidated financial statements of Davis Behavioral Health, Inc., a nonprofit corporation, for the year ended June 30, 2005 and have issued our report thereon dated January 31, 2006. As part of our audit, we have audited Davis Behavioral Health, Inc.'s compliance with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions applicable to each of its major State assistance programs as required by the State of Utah Legal Compliance Audit Guide, including the requirements of DHS-9 and DHS-10, for the year ended June 30, 2005. Davis Behavioral Health, Inc., received the following major assistance programs from the State of Utah:

- Mental Health (General Fund) Department of Human Services
- Substance Abuse Treatment (General Fund) Department of Human Services
- Juvenile Court (General Fund) Department of Corrections
- Drug Board (General Fund) Department of Human Services
- Outplacement (General Fund) Department of Human Services

Davis Behavioral Health, Inc. also received the following nonmajor grants, which are not required to be audited for specific compliance requirements: (However, these programs were subject to testwork as part of the audit of Davis Behavioral Health Inc.'s financial statements.)

- PASRR (General Fund) Department of Human Services
- Forensic Evaluation (General Fund) Department of Human Services
- Corrections (General Fund) Department of Corrections
- Juvenile Court Evaluation (General Fund) Department of Corrections

The management of Davis Behavioral Health, Inc. is responsible for its compliance with the compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standard applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about Davis Behavioral Health, Inc.'s compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, Davis Behavioral Health, Inc. complied, in all material respects, with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; special tests and provisions that are applicable to its major State assistance programs for the year ended June 30, 2005.

Tanner LC

January 31, 2006